



HF 2471 – Supplier Income Tax Exemption (LSB 5279HZ.1)
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Fiscal Note Version – As passed by the House

Description

House File 2471 creates an income tax exemption for corporate income earned by S-Corporation and C-Corporation businesses that are, at least in part, suppliers to Iowa anchor manufacturers. The exclusion is equal to the Iowa-apportioned income that exceeds the company's Iowa apportioned income in a base year. The base year calculation grows 5.0% per year with each additional year's exemption calculated from the base year income incremented by 5.0% per tax year. The exclusion is available for tax years beginning on or after January 1, 2012. The Iowa Economic Development Authority (IEDA) may not issue new certificates after January 1, 2015.

In the Bill:

- Certified supplier means a business certified by the IEDA. The IEDA is required to certify all suppliers that:
 - Manufacture tangible personal property at one or more facilities in Iowa and derive more than 10.0% of gross sales of tangible personal property from one facility in Iowa through sales to one or more Iowa anchor manufacturers.
 - Provide a statement from one anchor manufacturer that the manufacturer meets the definition of an anchor manufacturer.
 - Have at least 10.0% of total payroll located in Iowa or the supplier employs at least 50 employees at a facility in Iowa.
 - Do not also qualify as an anchor manufacturer.
 - Make all of their sales to anchor manufacturers at arm's length.
- Anchor manufacturer is defined as a business that manufactures tangible personal property at a facility in Iowa and exports at least 50.0% of the tangible personal property produced at the anchor manufacturer's Iowa facility to markets outside of Iowa.

Each certified supplier will continue to benefit from the exclusion as long as the supplier has Iowa apportioned income in excess of the base year Iowa-apportioned income, incremented by 5.0% each tax year. For calculation of the taxable income exemption, net income that is the result of a merger or acquisition that occurs after the base year is established for the business is not included. The Bill applies retroactively to tax years beginning on or after January 1, 2012. The IEDA may not issue new certificates after January 1, 2015, so the Bill impacts only tax years 2012, 2013, and 2014.

Background

The net income of C-Corporations is taxed by Iowa at the business entity level, while S-Corporations are generally taxed through the individual income tax returns of the owners. The business structure for both entity types is defined through the federal Internal Revenue Code (IRC).

Many provisions of the Bill are difficult or impossible to estimate. The data necessary is not available. The Department of Revenue provided a fiscal impact estimate based on a portion of the universe of potential beneficiaries from this proposed tax change. The universe includes only companies with facilities that are currently operating in Iowa.

Using the most recent three years of C-Corporation tax returns available, the Department of Revenue provided an estimate based on manufacturing C-Corporations with Iowa apportioned income growth sufficient to benefit from the proposal. The Department's estimate should be considered a maximum for the subset of companies, but the estimate does not include companies that are not categorized as manufacturers and it does not include S-Corporations.

The Bill has several broad definitions that make developing a reasonable estimate of the fiscal impact of the Bill problematic.

Manufacturing includes "combining of different materials" and "extracting and recovering natural resources." This definition could include biodiesel blending and production, ethanol blending and production, vehicle or heating fuel delivery, electricity production (including wind), and perhaps the delivery of natural gas.

An anchor manufacturer is defined as any business that exports at least 50.0% of what it produces at a facility in Iowa to out-of-state buyers.

- There is no requirement that an anchor manufacturer be of a specific employment or sales size. An anchor manufacturer could be a C-Corporation with 1,000 employees or it could be a business with one employee.
- There is no requirement that the tangible personal property purchased from a certified supplier be included by the anchor manufacturer as part of tangible personal property sold and exported out of state.

A qualifying supplier must supply at least 10.0% of the tangible personal property the supplier produces at an Iowa facility to an anchor manufacturer. This requirement also means that up to 90.0% of what that facility produces may be sold elsewhere in the State, and it means that anything else that qualified supplier produces at other facilities could be unrelated to supplying an anchor manufacturer. As long as the business meets the production requirements at one facility and also meets the employment thresholds, all Iowa-apportioned income growth by the business that exceeds the 5.0% growth requirement will be exempt from Iowa business income tax and this will be true even if the growth is not related to supplying an Iowa anchor manufacturer.

A certified supplier could also increase its Iowa-apportioned income by under-bidding another Iowa-based supplier to an Iowa anchor manufacturer, a situation that could increase the net income of the business but not result in any additional Iowa-based production.

Fiscal Impact

The Department of Revenue calculates that the maximum impact of the Bill, for C-Corporations only, will result in a decrease of tax revenue to the state of \$44.52 million over the three tax years. To account for three provisions that limit the types of transactions that qualify (arm's length, merger/acquisition restrictions, and requiring that certified suppliers not be anchor manufacturers), the Department maximum is reduced for this estimate by 30.0% to \$31.16 million.

The Department of Revenue was unable to provide a fiscal estimate for S-Corporations. The Department was able to provide statistics showing that the number of S-Corporation

manufacturing firms in Iowa is approximately 63.0% of the number of C-Corporation manufacturing firms. Multiplying the \$31.16 million times 1.63 yields a three-year total of \$50.80 million.

The Department of Revenue estimates that approximately 57.0% of identified C-Corporation and S-Corporation manufacturers meet at least one of the employment threshold requirements in the Bill. Applying 57.0% to the \$50.80 million yields \$28.84 million.

However, the above math assumes two things:

- All C-Corporations and S-Corporations categorized as manufacturers are certified suppliers to anchor manufacturers.
- Only businesses categorized as manufacturers will qualify as certified suppliers to anchor manufacturers.

In practical impact, neither number one nor two above will be true, but they will offset. Some percentage of Iowa manufacturers will not qualify as certified suppliers because they will not provide at least 10.0% of the tangible property they produce at a single facility to a qualified anchor manufacturer. But also, some businesses that are not categorized as manufacturers will in fact meet the 10.0% supplier threshold and their income subject to Iowa tax could be reduced.

The Bill applies only to tax years 2012, 2013, and 2014. After 2014, the IEDA and the Department of Revenue are required to consult with the Chairpersons of the Economic Growth and Rebuild Iowa Committees of the House and Senate.

The estimated reductions in General Fund revenue associated with the income tax exemption created in the Bill are:

- FY 2013 = \$ - 4.90 million
- FY 2014 = \$ - 8.47 million
- FY 2015 = \$ -10.57 million
- FY 2016 = \$ - 4.90 million

Sources

Department of Revenue
Legislative Services Agency analysis

/s/ Holly M. Lyons

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The fiscal note for this bill was prepared pursuant to [Joint Rule 17](#). Data used in developing this fiscal note is available from the Fiscal Services Division of the Legislative Services Agency upon request.
